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September 19, 2002

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

Ex Parte: **Federal-State Joint Board on Universal Service, CC Docket No. 96-45; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements, CC Docket No. 98-171; Telecommunications Services for Individuals with Hearing and Speech Disabilities and the Americans with Disabilities Act of 1990, CC Docket No. 90-571; Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size, CC Docket No. 92-237, NSD File No. L-00-72; Numbering Resource Optimization, CC Docket No. 99-200; and Telephone Number Portability, CC Docket No. 95-116**

Dear Ms. Dortch:

On September 18, 2002, Susanne Guyer, Don Evans and Ed Shakin met with Commissioner Kevin Martin and his legal assistant, Daniel Gonzalez to discuss why a collect-and-remit a revenue-based system is the best method for assessing universal service contributions and why the Commission should not adopt a per-connection methodology. The attached material was used in the discussions.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, an original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

W. Scott Randolph

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Attachment

cc: Commissioner Kevin Martin
Daniel Gonzalez

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Myth v. Reality

Why the connection-based method doesn't work

The Coalition for Sustainable Universal Service claims that the current revenue-based assessment mechanism must be changed to a connection-based system. The Coalition raises a number of arguments about why the current method cannot be salvaged and how a new method will benefit customers. This paper examines their arguments and explains why they just do not stand up to scrutiny. The Coalition is playing a shell game, hoping to sell the Federal Communications Commission on an impossible promise – that the FCC can collect more money for the federal universal service fund by charging consumers less.

Issue	✔ Myth	✔ Reality
1. Contributor base	A connection-based method would broaden the base of contributors to universal service.	A connection-based proposal actually narrows the base of contributors, because any future increases in USF charges would have to be shouldered only by local, wireless, and paging customers – and none by long distance.
2. Growth of interstate revenues	Interstate revenues are declining and in a "death spiral."	When the actual numbers are examined, there is no evidence of a large scale, systematic decline in interstate revenues. The Coalition picks several worst-case scenarios and combines them into an inaccurate picture of the future of interstate revenues. The scenarios cited by the Coalition – if they occurred individually – would only raise the universal service contribution to between 8.1% and 9.3%.
3. Growth of connections	Connections would continue to grow and provide a stable base for assessments.	The Coalition's assumption is unproven. For the first time in history, wireline connections are shrinking and wireless growth is tapering off. In addition, customers – not connections – ultimately would pay the universal service bill. The amount charged would stay the same regardless of the manner of assessment.
4. Consumer burden	A connection-based method would produce more universal service funds, while decreasing customer contributions to the fund.	FCC staff has estimated that consumers would pay about the same amount no matter what assessment method is used. *See* NPRM, ¶46. The Coalition acknowledges, in fact, that residential customers now pay less under the revenue-based method than they would under the proposed connection-based method ($0.96 v. $1.00). *See* Coalition Comments, at 62.

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<table>
<tr><th>Issue</th><th>✔ Myth</th><th>✔ Reality</th></tr>
<tr><td>5. Administrative burden</td><td>A connection-based method would be simpler to administer.</td><td>The FCC would have to define what is a “connection” and how to assess multi-line business customers. Even the Coalition admits that there should be a one-year transition for certain services because “converting to a connection- and capacity-based system will require carriers to deploy scarce IT resources for the development of new contribution and collection systems.” See Coalition Comments at 58.</td></tr>
<tr><td>6. Impact on interstate revenues</td><td>A connection-based method addresses the decline in interstate revenues.</td><td>As stated in item 2 above, there is no evidence of a decline in interstate revenues. Shifts in interstate demand – to wireless and broadband, for example – could be addressed just as easily through a revenue-based system. Expanding the base for the schools and libraries fund to include all broadband providers would be a good first step.</td></tr>
<tr><td>7. Identifying interstate revenues in bundled offerings</td><td>A connection-based method would eliminate the problem of identifying interstate revenues in bundled offerings.</td><td>Any method selected would have to make assumptions to deal with the issue of bundled offerings. The revenue-based method relies on factors, which can be calculated from readily available data. Such factors would produce fewer market distortions than a connection-based method.</td></tr>
<tr><td>8. Carrier contributions</td><td>A connection-based method would provide a “fair basis for assessments.”</td><td>Under the Coalition’s proposal, long distance carriers would shift from being majority contributors to contributing almost nothing. See NPRM, ¶59.
<table>
<tr><th>Method</th><th>IXCs</th><th>LECs</th><th>Wireless</th></tr>
<tr><td>Revenue-based</td><td>63%</td><td>23%</td><td>14%</td></tr>
<tr><td>Connection-based</td><td>0%</td><td>76%</td><td>24%</td></tr>
</table></td></tr>
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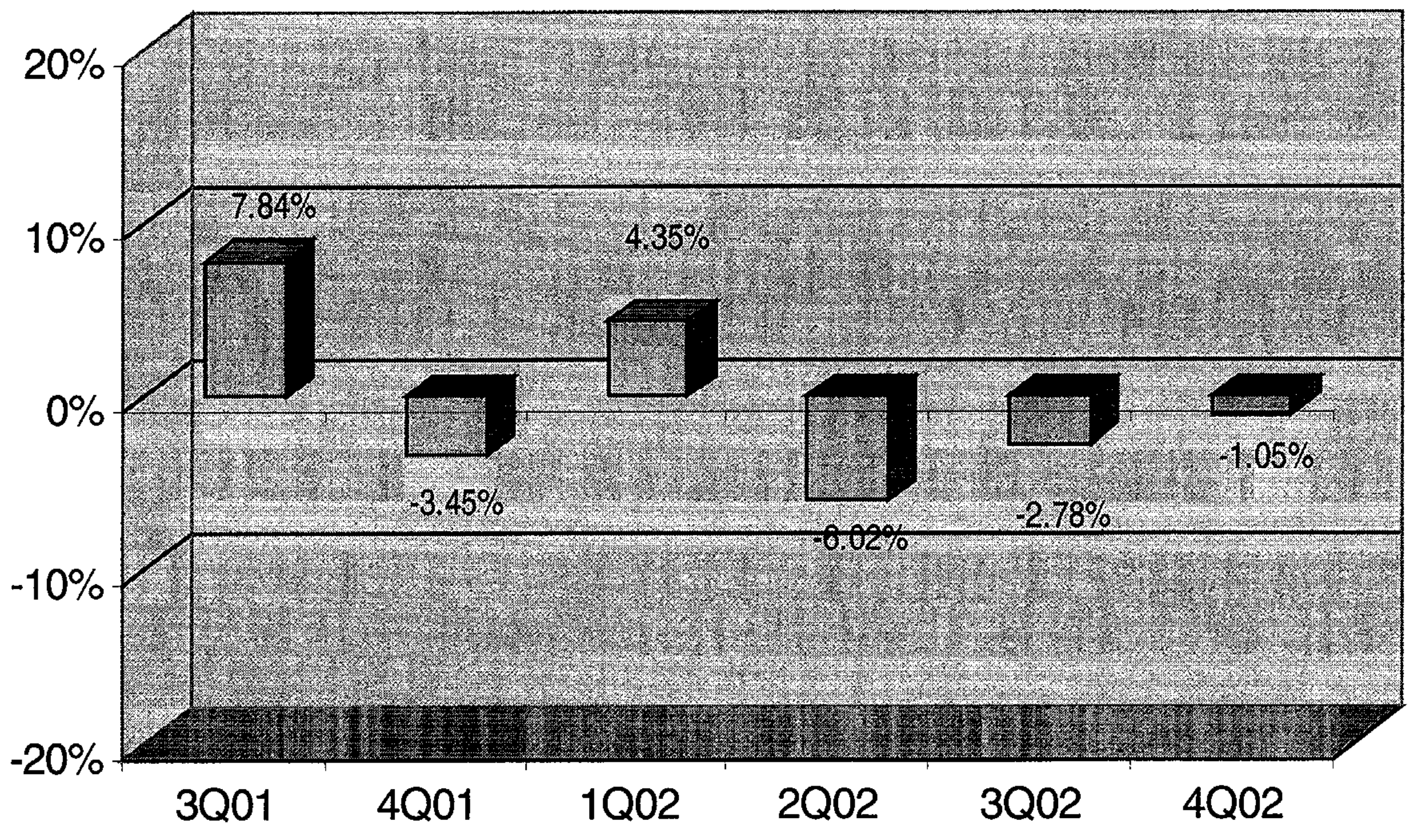
Verizon recognizes that there are problems in the current system and has proposed targeted solutions to the FCC to address them:

- <u>Uncollectibles / lag time</u> – The FCC should maintain a revenue-based system, but adopt a collect-and-remit process based on current revenues. Under such a system, USAC would set the quarterly contribution level based on projected needs. Carriers then would remit payment based upon that percentage as applied to revenues actually collected from all customers.
- <u>Broadening the base</u> – As a first minimum step, the FCC should require all providers of broadband services – including cable modem, fixed wireless, and satellite providers – to contribute to the schools and libraries fund. Today, only DSL providers contribute to the entire universal service fund. The FCC also should begin a proceeding aimed at ensuring that all providers of interstate services are contributing an appropriate amount.

Stripped of all the rhetoric, the Coalition’s connection-based proposal would virtually eliminate contributions from long distance carriers that generate the most interstate revenues and shift the burden to local exchange companies and wireless carriers. The Coalition is urging the FCC to engage in an open-heart operation to save the universal service system when all that is required is minor surgery.

Change to Universal Service contribution base



Note: USAC began collecting quarterly data as of 3Q01

How would the collect and remit proposal work?

Current process	Verizon's proposal
1. On Form 499, all providers of interstate telecommunications services report their gross billed interstate revenues for each quarter. The amount billed to recover contributions is reported on an annual basis. 2. The Universal Service Administrative Company (USAC) projects the funding need for the next quarter of the year. 3. The FCC establishes the contribution factor for the next quarter by dividing the projected funding need by the total industry interstate revenues from the past quarter of the year (including a 1% carrier uncollectible adjustment). The current factor is 7.28%. 4. This results in a contribution factor that is assessed on a six-month time lag. For example, the gross billed interstate revenues for the first quarter of the year are reported in the second quarter. The anticipated funding need for the third quarter is also developed during the second quarter. A contribution factor for the third quarter is calculated by dividing the projected funding need by the total industry interstate revenues from the first quarter. This contribution factor is used by firms to develop a charge that is billed in the third quarter. 5. Contributing firms develop their next quarterly contribution charge assessed upon their customers by considering: whether their revenues are increasing or decreasing; their uncollectibles; administrative expenses associated with billing, collecting and remitting monies to the administrator; and other factors (*e.g.*, their projection of billable units during the next quarter). 6. In some cases, these adjustments have resulted in billing an amount that is substantially different than the contribution factor published by the FCC.	1. Form 499 would be revised to require interstate telecommunications service providers to report net interstate revenues actually received from customers (not including the amount that recovers the providers' contributions to the federal universal service fund), rather than gross billed interstate revenues. 2. Each quarter, all providers of interstate telecommunications services would report the net amount of interstate revenues received from their customers (not including the amount that recovers the providers' contributions to the federal universal service fund) during the previous quarter on the revised Form 499. 3. USAC would project the funding need for the next quarter of the year. 4. USAC would incorporate both carrier and end user uncollectible factors, and would project total industry interstate revenues that would actually be received by contributing telecommunications firms for the next quarter. This projection would use statistical methods similar to those successfully used by the FCC staff and by NECA. This projection would be reasonably accurate at the start, and would become more so as additional data points become available and more experience is gained. 5. The FCC would develop the contribution factor for the next quarter by dividing the projected funding need by projected total industry interstate revenues to be collected from consumers. 6. Firms would develop their charge to customers based upon the contribution factor. This charge could be developed as either the published contribution percentage times the monthly interstate charge on the individual bill, or as a flat monthly amount reasonably reflecting the average interstate charges for a class of customers, such as single line residential and business customers. (Verizon uses the latter approach because it is more stable and predictable for consumers, and costs less.) 7. As today, contributing firms would be able to mark up the contribution factor by a small amount to reflect administrative expenses solely related to billing, collecting and remitting to the fund administrator. This administrative markup should be limited to a "safe harbor" amount (typically 1% to 3% in state programs). The FCC would develop the administrative "safe harbor" level and could require contributing firms to justify any administrative mark up above the "safe harbor" level. ▪ Because the contribution factor already reflects net revenues, there is no need for an uncollectible markup. 8. Firms that add a contribution charge to their bills would label it to alert consumers that it represents recovery of contributions to the federal universal service program. Typical line item labels would include: "Federal Universal Service Contribution," "Federal Universal Service Fee," or "Universal Connectivity Fee." 9. Contributing firms would remit to the fund administrator an amount equal to the contribution percentage times their actual interstate revenues for a quarter (not including the amount that recovers the firm's contributions to the federal fund). This means a firm could choose to not charge a customer for competitive or other reasons, but would still have an obligation to provide contribution for that customer's interstate revenue amount. ▪ Because the administrative safe harbor amount would be the only mark up permitted, firms would not be able to make up from some customers amounts not charged to other customers. ▪ Because contributions for each firm are based on their current revenues, there is no need for contributors to adjust their charges to customers for declining or increasing revenues.